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The Voice of the Investment Management Consultant

What Is Advice? HNW Standards Initiative Publishes Asset/Liability Study Working Document

Stephen C. Winks

As financial advisors, what is our obligation to our clients? Do we simply make investors aware of investment alternatives and let the investor, with limited knowledge and investment expertise, muse on investment merit and make their own investment decisions? If so, isn't the investor acting as their own counsel? Isn't the role of the financial advisor then minimized to offering product access and trade execution services? Yet, this has been the traditional role that financial advisors and their supporting firms have fulfilled. No advice is implied or rendered, there is no accountability for investment recommendations, and the role of the firms supporting financial advisors is limited to product access and trade execution. This places the investor in a difficult position of having to exercise judgment in areas in which they are not well versed. All investors would prefer their investment advisors to selflessly act in their best interest in making informed investment recommendations. This is a higher level of counsel with well-reasoned recommendations and accompanying accountability encompassing all the client's holdings. The role and counsel of the advisor would be maximized. But for the client who is hoping for a higher level of counsel, it is difficult to determine in what role the financial advisor is acting. Is the advisor simply posing investment alternatives or are they making a well-reasoned investment recommendation?

Although all clients want a higher level of counsel, is that the capacity in which their advisors act? The confusion arises in there being no institutionalized support for advisors to offer high level counsel. There is no institutionalized AIMR-compliant account aggregation capability essential for the advisor to add value. There is no institutionalized investment policy statement capability with legal opinions that guide the

governance and management of the client's portfolio. There is no institutional monitoring of all of a client's holdings that would "constitute continuous comprehensive" counsel implied by regulatory mandate. So, if high level counsel is being provided, it is only by the initiative of the individual financial advisor. This results in a very high hurdle that the advisor must overcome, as they must create their own processes and technology necessary to address and manage the full range of investment and administrative values required by regulatory mandate.

In order to alleviate this technological burden of advisors and the firms that support us and to reduce the

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AS A WEB LINK CITING
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SUPPORTING PRACTICE
STANDARDS AND BEST
PRACTICES**

labor intensity of high level counsel, the Society of Senior Consultants, in concert with AICPA, the Foundation for Fiduciary Studies, Dalbar, leading advisors and leading technical support firms that support high level counsel, have formed the High Net Worth Standards Initiative to define the processes, technology and the full range of investment and administrative values that must be managed in order for the advisor to fulfill their fiduciary responsibility to their clients. The resulting [High Net Worth Asset/Liability Study Working Document](http://www.SrConsultant.com/Society/HNW-Working-Index.html) (<http://www.SrConsultant.com/Society/HNW-Working-Index.html>)

citing case law, statute and regulatory opinion letters supporting practice standards and best practices. The High Net Worth Asset/Liability Study Working Document outlines what is required of us as financial advisors in fulfilling our fiduciary responsibilities to our high net worth clients. Because we are obligated to look at a client's circumstance and evaluate all of his holdings before we make an investment recommendation, the Asset/Liability Study explores the full range of investment considerations and sets up everything we do as advisors and thus establishes the depth and



breadth of our counsel. Thus, in defining advice, we are essentially defining the Asset/Liability Study or what is required of us as financial advisors.

A parallel companion, the Technological Blueprint, will be published (in *Senior Consultant*, April 2004) by the High Net Worth Standards Initiative, which will delineate the technology necessary for advisors to fulfill their fiduciary responsibility, and address and manage the full range of investment and administrative values. The Technological Blueprint creates a context in which one can see the importance, the interconnectivity and the value of all the component parts.

The objective of the High Net Worth Standards Initiative is to foster technological innovation that will empower all advisors to (1) offer continuous comprehensive counsel, (2) address and manage the full range of investment and administrative values required by regulatory mandate, and (3) fulfill their fiduciary responsibility.

The findings of the High Net Worth Standards Initiative are based upon the definitive research by the Foundation for Fiduciary Studies, which cites case law, statute and regulatory opinion letters in establishing practice standards that constitute the breadth of our counsel. Leading industry figures such as **Harold Evensky**, past chairman of the CFP Standards Board; **Guy Cumbie**, past chairman of the FPA; **Jim Pupillo**, past president of APIC, ICIMC now IMCA; top advisors (**Bob Rowe**, **Dick Smith**, **Hugh Anderson**, **Rich Todd**, **Robby Hazzard**, **Vince Birley**, **David Perkins**); and leading industry experts (**Ron Pruitt**, tax efficiency/overlay management; **Ron Surz**, performance evaluation/attribution analysis; **Amy Otteson**, manager search and selection; **Bob Rowe**, tactical asset allocation/investment policy; **Bob Padgett**, investment policy; **Bevin Crodian**, process/technology; **Madelyn Jackrel**, subaccounting, trade and order routing, reporting; **John Michel**, attribution analysis/portfolio analytics; **Joe Maxwell**; account aggregation/AIMR reporting) have defined the depth of our counsel which constitutes best practices, in

the context of the regulatory mandates within which we are obligated to work. The time and effort expended by all is an invaluable contribution to the elevation of the role of the financial advisor and the counsel they provide.

The High Net Worth Asset/Liability Study Working Document is a living document, as it should always reflect our best thinking on working with high net worth clients. There is a great opportunity for technological innovation that will greatly elevate our counsel beyond what is humanly possible to provide today. Thus, with your continuous input, there is a wonderful opportunity to continuously elevate

THE OBJECTIVE OF THE HIGH NET WORTH STANDARDS INITIATIVE IS TO FOSTER TECHNOLOGICAL INNOVATION THAT WILL EMPOWER ALL ADVISORS TO (1) OFFER CONTINUOUS COMPREHENSIVE COUNSEL, (2) ADDRESS AND MANAGE THE FULL RANGE OF INVESTMENT AND ADMINISTRATIVE VALUES REQUIRED BY REGULATORY MANDATE, AND (3) FULFILL THEIR FIDUCIARY RESPONSIBILITY

the role and counsel of the financial advisor. The High Net Worth Asset/Liability Study Working Document should be ever-changing, based on technological innovation and your good work in finding better ways to serve your clients.

As we edited the comments and thoughts of our many contributors, we found much affirmation as each contributor independently submitted their comments. It was uncanny how Harold Evensky would ask, "Don't we need to expand this point to be more specific," and Bob Rowe or Ron Pruitt independently and concurrently would feel the same way and provide the technical details in their edits. Though extremely time-consuming, it is amazing how

well everything flowed together. The most surprising observation is that none of what is required by regulatory mandate is particularly complex. It is just when you look at it on the whole, it is the order of magnitude of detail that must be managed that makes fiduciary responsibility so complex to manage for individual advisors. Eighty percent of the fiduciary responsibility requires disclosure or reporting, which lends itself perfectly to automation, and by extension, the alleviation of a tremendous administrative burden. Yet, there is skill required in high level counsel that transcends procedural prudence, that is more art than science. As we go beyond post-modern portfolio theory, we should be humbled by all that we don't know and all that is unknowable. As Ron Surz observed, "How do you reach into a client's soul and elicit that all important risk assessment and pull out the magic that will allow the client to sleep well at night and achieve their goals and objectives?" Just as there is much we don't know and much that will remain unknown, we should also not stop questioning what we know. That is how we got to post-modern portfolio theory. So, you are encouraged to offer your thoughts on ways we can elevate your counsel. **David Loeper** and other leading figures in our industry have much to say on risk and other issues that will elevate the industry and the counsel we provide.

It is important to note that high net worth individual investors are not fiduciaries because it is their money, and they are investing on their own behalf. So, by extension, you may wonder is there a need for a fiduciary standard in dealing with individual investors? The answer is that it all depends on the investor. Most high net worth investors have the same concerns as fiduciaries who are acting on behalf of others. They would rather not act as their own counsel in managing their own assets or even supervise professional money managers. Thus, many high net worth investors see the wisdom of both engaging professional money managers and an investment management consultant who not only acts as a co-fiduciary in monitoring the broad range of



investment and administrative values required by regulatory mandate but also acts as an intermediary between the investor and money managers. We should be clear that high net worth investors do not have to engage professional investment and administrative counsel to act as an intermediary, as they can act on their own in making investment decisions. Nor do advisors have to act in a fiduciary capacity entailing accountability for investment recommendations. Investors can become their own counsel and exercise their own judgment. Yet, investors are increasingly aware of the value of well-informed, unconflicted advice. For advisors who wish to fulfill their fiduciary obligations and engage their on-going counsel for a fee, the High Net Worth Asset/Liability Study Working Document establishes what is required in the engagement of their counsel.

Does this mean that every stockbroker, financial planner, insurance salesman, banker, CPA and trust officer is doing it all wrong? No. It means by having a point of reference of what is required as financial advisors, we can garner institutional support from venture capitalists, technologists and advisor support organizations to create the processes and technology necessary to add value and fulfill our fiduciary responsibilities. We should not expect that our industry's largest firms will have an epiphany and overnight develop a new culture, structure and technology necessary to empower their advisors to add value and fulfill their fiduciary responsibilities. But we will see enterprising technologists develop the technology that will reduce the labor intensity of high level counsel. For example, **Bob Padgett** of Klein Decisions (mathematic weighting of each investment consideration for each investor) and **Bob Rowe** of Rowe Decision Analytics (IPS documentation and legal opinions) are independently developing complementary investment policy statement technology to which advisors will have direct access. As innovations like this occur, advisor support firms will have to embrace regulatory-mandated innovation by either allowing their advisors to directly secure investment policy statement capability or by providing it for all their advisors. It is no longer an option for

firms to deny the fiduciary responsibility of their advisors or to deny access to technology that allows fiduciary responsibility to be fulfilled. If access is provided, it must be provided to everyone. How else would one explain that some advisors are enabled and capable while others are not? If they are not enabled or capable, what is the rationale of firms having those advisors working with clients? This triggers a chain of events that requires advisor support firms to re-engineer advisor support around the highest common denominator of fiduciary responsibility, rather than the lowest common denominator of trade execution. Clearly, all investors want value to be added, and it is in the best interests of the advisor to address and manage the full range of values

WE SHOULD NOT EXPECT THAT OUR INDUSTRY'S LARGEST FIRMS WILL HAVE AN EPIPHANY AND OVERNIGHT DEVELOP A NEW CULTURE, STRUCTURE AND TECHNOLOGY NECESSARY TO EMPOWER THEIR ADVISORS TO ADD VALUE AND FULFILL THEIR FIDUCIARY RESPONSIBILITIES

required by regulatory mandate. Thus, the High Net Worth Asset/Liability Study Working Document becomes a catalyst for innovation by simply cajoling and jawboning market forces into action. There is no ambiguity in the case law, statutes or regulatory opinion letters cited. Clearly, no major advisor support firm would embrace radical changes in its culture, structure and technology unless it would be good for business. Yet, because the resulting new advice business model has half the cost structure, three times the multiple and exponential enhancement in client service, no one would argue that innovation is not essential and beneficial to all. The only way to manage technological innovation is to provide universal access and let the market forces determine the outcome. The technology exists; it is just a question of whether firms understand the process and technology necessary to add value, embrace

innovation and empower their advisors to use it.

It is important that innovation and the acknowledgement of fiduciary responsibility be institutionally embraced rather than each individual advisor having to take the initiative, as the early adopters have had to do. We still may be in the early adoption phase where less than 16% of all advisors are committed to adding value and have created their own processes, technology and division of labor within their practices necessary to add value and fulfill their fiduciary responsibility. When breakthrough innovations occur, like web-based investment policy statement capability, we will quickly enter into the early majority phase of innovation that penetrates an additional 33% of the market, thus establishing a new business model and culture that will reorder the industry around adding value. The reason why it is important that innovation is institutionalized is that it accelerates the industry's evolution with preemptive processes, technology and infrastructure that constitutes an unprecedented level of professional investment and administrative counsel without requiring each and every advisor to reinvent the wheel every step along the way. It is the difference between a small cottage industry where everyone does everything differently and a well-run business/industry where functions are well-defined and costs are aggressively managed with scale.

Today, every advisor has to reinvent the wheel; every advisor has a different level of sophistication, a different take on fiduciary responsibility and adding value. Advice can mean anything you want it to mean, but in defining advice as we have in the High Net Worth Asset/Liability Study Working Document, we begin to make it manageable for technologists to create very specific technology that is beyond any of us individually, yet is far less expensive than anything currently available. We also begin to make professional investment and administrative counsel into a profession. This mantra of faster, better and cheaper is about to reverberate throughout the financial services industry. When Pandora's box is open, no one will want to go back. Most

importantly, the role and counsel of the financial advisor will be the value added. Everything else will be a commodity.

This renaissance of professional investment and administrative counsel and elevation of the role and counsel of the advisor all starts with an understanding of what is required of us as investment advisors and how to cost effectively execute that counsel. This has been largely accomplished by the High Net Worth Asset/Liability Study Working Document and the accompanying Technological Blueprint that will set market forces to work.

I would like to thank all who participated, with special thanks to **Harold Evenksy, Ron Pruitt, Bob Rowe, Amy Otteson, Ron Surz, and Bevin Crodian**. I would also like to thank **PowellJohnson**, who financed this project. PowellJohnson is elevating the role and counsel of the financial advisor by funding research that defines advice, acknowledging fiduciary responsibility and building the support infrastructure that will empower our industry's most accomplished advisors to excel.

These are exciting times for the financial services industry, as the transparency of the internet is making it clear who is adding value and why others can't. It could not be any better for advisors who are in the vanguard of the reordering of the financial services industry around continuous, comprehensive counsel that is required by regulatory mandate. As advisors, you are no longer in this all alone; there are firms and technologies unfolding that will help you offer the best thinking and the highest level of counsel possible, entailing an incredible amount of portfolio detail that will be cost effectively managed. We welcome your thoughts on how we can better serve our clients, reduce the labor intensity of advice while minimizing the associated cost and staffing of the enabling processes and technology. To the end of elevating the role of the financial advisor and the counsel we provide, we commit the High Net Worth Asset/Liability Study Working Document to the public domain and ask for your vigilance and on-going contributions in elevating counsel our industry provides. ■

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